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General Business Conditions

THE weeks since the election have been heartening to business. A strengthening of confidence is evident not only in general comment, but in rising stock prices and a leveling out of the earlier commodity price decline. One reason is the good character of most current business reports. Except in wartime, industrial activity has never been so high. While new orders are not uniformly big in all lines, this is partly because buyers are already well covered, and unfilled orders in the aggregate hold at the peak. The demand for labor shows no abatement. The flow of personal income has risen substantially since summer, and the gain has been in terms of real purchasing power as well as dollars. Although department store sales in November have not equalled October's unusually good showing, the high employment and income figures maintain confidence in the retail trade outlook.

Reports from the heavy industries, where the first significant signs of softening will be looked for, suggest that the prospect is still bright. Awards of construction contracts, representing work to be done in the future, have continued encouragingly above a year ago. Government agencies estimate that total construction in 1953 will slightly exceed 1952, and most private estimates are optimistic. The first survey of intended expenditures on business plant and equipment in 1953, made by the McGraw-Hill organization, indicates a decline from the 1952 peak of less than 4 per cent, which is smaller than most people have been expecting. Adding to these indications the prospective rise in defense expenditures, many business men see reason to extend their confidence a little farther into the future and to date a little farther off the beginning of the recession which has been so widely predicted.

Influence of the Election

To this growth of confidence the election of General Eisenhower to the Presidency and his excellent appointments to the Cabinet and other offices have contributed. In pre-election discussion, and even later, the opinions expressed as to the state of business activity following a Republican victory were not uniformly optimistic. It was argued that the very steps to reduce government spending and halt the long inflationary rise, which the voters desire and expect from the new President, would necessarily subtract demand from the markets; and some feared that the effect on business would be deflationary.

Four weeks after the election, a practical rebuttal of this argument has come from the firmness of the markets themselves. With respect to the short run outlook, it should be realized that new policies cannot be implemented rapidly. The size and complexity of the Federal Government, which far exceed that of any other organization of any type anywhere in the world, make immediate and sharp reductions in spending difficult, for study must be made of the areas in which efficiencies may be instituted, purchases spread over a longer period, and programs cur-

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tailed. Defense expenditures have a momentum which can hardly be arrested in the short run, because many are imperative and because the Congress has authorized contractual obligations and appropriated funds against them. These funds flow out in a stream which is still expected to expand in the months ahead.

Economy Is Constructive

In principle, also, the argument that economy would be bearish was never a worthy one. To be sure, the arithmetic of the matter would show that a reduction in government spending would reduce demand for goods and services, at least until it had gone far enough to permit offsetting tax reduction. But simple subtraction would not give the whole answer. A policy of eliminating waste and non-productive work, improving government practices, balancing the budget, moving toward tax cuts, terminating unnecessary and disruptive controls, and providing fairer and more competent regulation of business where regulation is lawfully established, would be bound in the long run to stimulate enterprise and promote private investment. When attention is centered on an expected drop in demand from one quarter it is easy to overlook the less measurable, but no less real, compensating gains that may take place elsewhere.

The country has had experience with a previous and far greater reduction in government purchases than anything now likely; namely, at the end of World War II. Even able and experienced economic analysts could not see, at that time, what could possibly come forward to fill the "gap" in demand. Predictions of unemployment ran as high as 8 to 10 million people. They proved, of course, to be utterly without basis. In concentrating upon the gap, the prophets of this school failed to realize the extent of people's wants and the vigor and ability with which the business organization would plunge into the task of satisfying those wants. Progress was held back by major strikes, but once these were out of the way an upsurge took place which filled the gap and carried economic activity to new highs.

In this experience there is a lesson for all time. During declared or undeclared war, when the influence of government purchases both actually and psychologically is at its peak, it is natural to think that business could not sustain a reduction in those purchases without depression. But this is not inherently or inescapably true. The question is whether private business, in its normal function of satisfying people's wants, will come forward to fill the gap. A change in Administration which establishes constructive new policies has an expansive influence upon private business.

To imply, as the pessimistic argument might do, that wasteful and fruitless government expenditure should be tolerated because to curtail it would be deflationary, would be an absurdity. If things are done better, the country will be better off. What is at stake is the public welfare, which requires that the resources of the country be devoted to productive work, at the highest possible level of efficiency, in an environment of order and stability. The fundamental reason why inflationary spending should be checked is that inflation creates the very opposite of these desirable conditions.

Sentiment Continues Cautious

Another opinion, namely, that the influence of a Republican victory may carry optimism to extremes, should need less extended discussion. According to this view the constructive policies to be expected may turn sentiment overly bullish and lead to forward buying, inventory accumulation, new decisions to build and expand, and speculation in one form or another — all to the extent of producing a new inflationary surge. Fortunately the improvement in sentiment gives no sign of going so far. Buying of commodities and merchandise, while confident, is orderly, temperate, and clearly influenced by expectation of greater supplies rather than less as time goes on. Insofar as new decisions to enlarge expenditures on plant and equipment may be made, they will more likely prolong rather than intensify the period of heavy goods activity, in part because of the time necessary for planning, contracting and financing, and in part because new orders for machine tools and many other things can only go to the bottom of an already long list.

Because of the intense interest in the election, and the momentous nature of a change of Administration after twenty years, discussion of the business outlook may for a time put too much emphasis upon the influence of government. Even with the vast intrusion of government into economic life, the bulk of the country's business is still for the purpose of satisfying people's daily wants; and many of the influences which determine the state of business are never continuously dominated by government policy. The present situation is strong and the outlook good. But business men who fear that a reaction must set in from the growth of debt, accumulation of inventories, the plant and equipment boom, disturbance of balance among costs, prices, incomes, and profits, and other consequences of

the long inflationary period, are bound to believe that these influences will operate in some degree independently of what government may do. This reasoning is very commonly encountered. It justifies and preserves caution. There is need of caution. An exaggeration of the boom, which could only lead to a more certain bust, would be a calamity.

Protecting the Dollar

The shrinking value of the dollar earned and saved has enforced itself upon the consciousness of every thoughtful citizen. Both the candidates during the election campaign devoted major speeches to inflation as one of the large public issues of the day. In the American lexicon inflation is the tendency of the cost of living every now and then to hit a new high point. This is not the worst variety of inflation, but even a slow and gradual erosion of money has fateful consequences.

President-elect Dwight D. Eisenhower on November 1 pledged that:

> . . . the full resources of our new administration will be thrown into the battle against inflation. Only if the steady whittling away of the value of the dollar is stopped, can our farmers, our factory and white collar workers, our aged, find any security in their savings, social benefits or pensions.

The importance of the issue is plain for inflation has inflicted poverty upon people past their working years, and has given intelligent younger men and women pause to wonder what their savings, pension rights, and life insurance protection will be worth. No doubt such considerations influenced many people as they went out to cast their votes. The threat is not alone to individual but to national security. Continued inflation can undermine not only the will to save, but trust in money and trust in the integrity of government. In Europe, nations whose savings generations ago helped to develop America have impaired the will to save and they are relying on American aid to make up the deficiency. Combinations of inflation and excessive taxation are the responsible cause.

Practical Measures

It is easy enough to be against inflation in principle. The practical question is what specifically to do about it.

There are three tools in the kit:

1. The Federal budget, discussed in a separate article in this *Letter*. This is paramount.

2. Public debt management. There is no early prospect of large debt retirement but the inflationary character of the existing debt can be neutralized by inauguration of a funding program.

3. Federal Reserve policy to curb credit expansion.

All three of these approaches have close interrelationships. It is worthy of special note that all of them bear on the savings flow. The budget, on the spending side, swells the demand for goods and waters down the value of the money the citizen has saved up. Taxes impair ability to save and also the incentive. Debt management offers means to give the saver a better break, either directly or through savings institutions, and to siphon off a marginal excess of funds entering the spending stream. Federal Reserve policy, acting broadly on the cost and availability of credit, can strengthen the will to save by making borrowing harder and dearer.

Debt Management

Prospective movements in the size of the public debt hang on the budget. Aside from this, there is the question of improving the structure by a process of funding floating debt. This means pushing maturities further out into the future, encouraging purchases for permanent investment holding, particularly among the savings institutions, and relieving the burden of current refinancing on the Treasury and on the Federal Reserve authorities. With the practice of favoring obligations of short-term, and giving optional redemption or conversion privileges, the gross volume of public debt instruments the Treasury has issued since December 31, 1945 runs to the fairly incredible total of $900 billion. The waste of paper and paper work is the smallest item; the need for floating these billions time and again has estopped the Federal Reserve from taking actions which could have given a heavier content to the 1952 dollar.

A swollen public debt is almost always an inflationary influence, if only because it makes the monetary authorities feel a force of necessity to put out a little more money every now and then to support bond prices and cheapen the cost of refinancing maturities. The inflationary influence is aggravated if the volume of debt of the "floating" variety — reaching maturity in the years just ahead — is disproportionately large. The monetary authorities then are bound to be heavily preoccupied with the Treasury's refinancing problems. Moreover, government obligations near to maturity, or redeemable on demand, are treated by the holder as the equivalent of cash. While not included in the usual statistics of money supply, they can have much the same influence on spending as so much extra cash would have. Funding floating debt — pushing debt maturities out — is one of the traditional

ways of dealing with inflation and protecting the value of money. A judiciously balanced debt structure is a hallmark of good financial house-keeping just as an excessive floating debt is a warning signal of threatened insolvency.

These considerations to the contrary, some people have argued that a large floating debt holds no peril. In time of stress, it is said, the Federal Reserve can use its money-issuing powers to take up Treasury securities that the market cannot absorb. Or the Congress can authorize issuance of paper money to pay off. These arguments, so far from disproving the peril, illustrate its seriousness. They show how easy it is for an unmanageable floating debt to convert itself into straight-out paper money inflation.

Structure of Debt

The structure of the debt, as detailed in the following table, is a cumulative result of borrowing policies pursued during the depression, war, and postwar periods:

Projected Structure of Public Debt, December 31, 1952

Redeemable on demand	Amounts in Billions	Percent of Tot. Debt	Cumulative Percentages
Spec. issues to gvt. trust funds	$38.8	14.5%	14.5%
Savings notes	6.0	2.3	16.8
Savings bonds	57.8	21.6	38.4
Other obl. red. on demand	3.4	1.3	39.7
Due in 1953			
Treasury bills	21.7	8.1	47.8
Certificates of indebtedness	16.7	6.3	54.1
Treasury notes	10.5	3.9	58.0
Treasury bonds	8.0	3.0	61.0
Due in 1954-57 (1-5 years)			
Treasury notes	19.7	7.4	68.4
Treasury bonds	18.0	6.7	75.1
Convertible into 5 year notes			
2¾% nonmarketable bonds	12.5	4.7	79.8
Due in 1958-62 (5-10 years)			
Treasury bonds	22.8	8.5	88.3
Due in 1963-72 (10-20 years)			
Treasury bonds	31.1	11.7	100.0
Total	$267.0	100.0%	100.0%

The emphasis of policy throughout has been on making government securities *liquid* – easily convertible into cash without important loss or risk for the holder. This principle was originally applied in 1935 to Savings bonds designed for the small saver, but later it was extended to F and G Savings bonds and Savings notes. Beginning about 1939 the same principle was invoked in favor of marketable securities – even the longest term bonds – in the shape of price support offered by the authorities in the open market. Whatever may be said for this policy in depression, it is a menace to stability in boom times – as was brought out in two Congressional investigations conducted since the war.

In the table the current figures have been projected ahead to the probable status on December 31 shortly before the new Administration takes office. Most striking in many ways is the absence of any maturities after 20 years. Only two years ago there were outstanding $25.9 billion in this category, small enough as a proportion of the total but still a respectable amount. Of these, $14.4 billion have been "unfunded" by exchange into 2¾ per cent nonmarketable bonds which in turn are convertible at the holder's option into five-year notes. Those unexchanged have moved down to the twenty-year point by passage of time. The last of the longest bonds, the residual of the Victory Loan issue, shrunk by conversions from an original $11.7 billion total to $3.9 billion, becomes a twenty-year maturity December 15.

Starting from the top of the table, obligations redeemable on demand run to 40 per cent of the public debt. These are a first concern to the Treasury for there must always be a preparedness to meet them. Many of the special issues to government trust funds involve little risk of sudden claims, though among them the unemployment trust fund, for example, might in some circumstances be forced to cash in heavily.

In light of the losses of buying power the holder has experienced, the record on Savings bonds has been surprisingly good. More than half of the "E" bonds sold during the war years, 1942-45, have been redeemed, but postwar sales have tended to balance redemptions. For the holder, the $35 billion outstanding E bonds represent a kind of savings deposit withdrawable on demand. The greatest merit in the E bond, and its companion current income H bond introduced last June, is the spread of ownership they give to the public debt. The other types of Savings bonds, plus the Savings notes and certain other obligations redeemable on short notice, take on much the same character as deposits withdrawable on demand. One specific problem the Treasury faces in 1953 is what to do about the $1 billion series F and G bonds sold in 1941 and still outstanding. These bonds, issued for twelve years, will run out and cease to earn interest. With the E bonds, when their ten year term ran out, the Treasury extended the interest-earning period to twenty years. It is possible that the F and G bonds can be supplanted with marketable bonds freeing the Treasury from obligation to redeem in advance of maturity.

Aside from the 40 per cent of the public debt redeemable on demand or at short notice, some $21.7 billion Treasury bills will be on the maturity calendar for the first half of 1953, including $4.5 billion sold during October and November specifically in anticipation of surplus revenues in March and June. The balance is represented by thirteen regular issues of 91-days'

term, replaced by new issues of similar amount as they come due.

During 1953 three issues of certificates of indebtedness fall due on February 15, June 1, and August 15, in the aggregate amount of $16.7 billion. An $8 billion issue of 2 per cent bonds matures September 15. A $10.5 billion note maturity falls on December 1.

Just beyond 1953, in the one-five year maturity zone, are $37.7 billion in marketable notes and bonds. Holders of $12.5 billion 2¾ per cent nonmarketable bonds can add to this total by exercising their options to convert into five-year notes.

Thus, in summary, debt which the Treasury can be called upon to deal with over the next five years comes in all to $213 billion, or four-fifths of the whole. The task boils down to one of reconstructing the public debt, and in a way and at a pace that will aid economic stability and assure the investor in new issues that he will get paid back money as good as he gave.

Background

The present shape of the debt goes back to types of paper used in financing World War II. As the following table shows, at the close of the 1946 fiscal year less than one-fifth of the debt was funded in bonds maturing beyond twenty years. In contrast, on June 30, 1919, after the close of World War I, half the debt matured after twenty years. On June 30, 1946 nearly half of the debt was due or redeemable at the option of the holder within one year. This proportion was less than one-fifth on June 30, 1919.

Structure of Interest-bearing Public Debt for Selected Years

Maturity	June 30 1919	June 30 1930	June 30 1946	Proj. Dec. 31 1952
Special issues*	—	4.8%	8.3%	14.6%
Maturing or redeemable† within a year	18.2%	8.9	44.3	46.1
One to five years‡	13.7	10.3	6.3	19.0
Five to ten years	16.2	39.9	16.8	8.6
Ten to twenty years	0.3	17.7	7.5	11.7
After twenty years	51.6	18.4	16.3	—
Total	100.0%	100.0%	100.0%	100.0%

* Generally redeemable on demand or on short notice.

† At the option of the holder.

‡ Including nonmarketable 2¾s of 1975-80, convertible on demand into 1½% five year Treasury notes.

Since the war the Treasury has followed the policy of rolling short-term debt over and over, paying some off when surplus revenues were available but adding at other times by issuing short-term paper in exchange for bonds reaching maturity or called for payment in advance of maturity. Apart from two issues of six and seven year bonds, no securities have been issued which do not give the holder an option to demand cash within five years. Such obligations do not represent funded debt in any true sense of the word.

The effect of this policy, as the table brings out, has been to shrink the proportion of funded debt and to swell further the amount due or redeemable within five years.

Fortunately we have a climate in which a beginning can be made toward reworking the debt structure. The Treasury earlier this year, in putting out the two issues of 2⅜ per cent bonds due in 1958 and 1959, made at least a probing effort in the right direction. These issues taught the market the lesson that it must appraise new bonds on their merits and not on a basis of price support provided by the authorities.

A main task is to redevelop a market for genuinely long term bonds and to combat a tendency among institutional holders to regard U.S. government securities simply as a temporary investment. This drift arises basically out of the reluctance of savers to accept depression-level rates of interest on their funds. They want a better deal and credit demands from other sources — corporations, States and municipalities, the mortgage market, etc. — have been large enough to enable savings institutions to give it to them. The Treasury cannot effect debt refunding without recognizing this basic change. The 2, 2¼, and 2½ per cent scale used in financing World War II is quite clearly outmoded.

Credit Policy

Public debt management and Federal Reserve credit policy are so closely meshed that some people have urged that the Federal Reserve's powers of money issue and the Treasury's duty of debt management be merged into one agency. The perils of such a merger were made abundantly clear in the controversy over bond price pegging two years ago. The Federal Reserve up to that time — as it had since the war years — found itself accepting Treasury veto power over policy actions. Not unexpectedly, credit policy was dictated mainly by the exigencies of public debt management and preservation of cheap money.

In the background of the controversy, and the two Congressional investigations into it, there is now broad agreement that the Federal Reserve must not feel bound to underwrite inflationary debt management policies desired by the Treasury. On the other hand, there is the continuing danger that the Federal Reserve will find acquiescence in cheap money policies the easy line of least resistance. It takes courage to resist inflation and a swollen schedule of public debt maturities is a plausible excuse for inaction.

Federal Reserve policy since the bond price unpegging has been directed toward gently retarding, rather than arresting, credit expansion. The unpegging itself was softened in its impact by the associated exchange offer of convertible 2¾s for War Loan 2½s, by support purchases during the transition to a free market, and by retention of the 1¾ per cent discount rate. Nevertheless, it effected a reduction in the liquidity of lenders. In connection with the Voluntary Credit Restraint Program and Regulations W and X, since abandoned, it had a broad retarding effect on credit expansion.

Since the bond price unpegging the Federal Reserve has come to the support of the government securities market around periods of Treasury financing but on no fixed price basis. Thus, for marginal supplies of funds, banks have taken recourse to borrowing from the Federal Reserve Banks at the 1¾ per cent discount rate. The revival of such borrowings has been spectacular. From an average level of $130 million during 1950, they ran up as high as $959 million in December, 1951. In July and August this year borrowings averaged slightly above $1 billion, and for November the average evidently will be closer to 1½ billion.

Banks have a natural reluctance to borrow; hence need to borrow to accommodate credit demands imposes a constraint on credit supply. This was most clearly evident in December a year ago and again in the past summer when considerable numbers of banks which had not had to borrow for many years found themselves faced with the practical necessity. Under adverse market conditions then prevailing, sale of government securities was not a reasonable option. In September, the Federal Reserve gave the market a breather, putting out funds in support of Treasury financing and relieving the necessity to borrow. In October and November borrowings have moved back up, and to a higher average level, even though the government securities market has been in better condition to absorb offerings. Meanwhile, since September, loan expansion has run beyond seasonal proportions.

This experience suggests the conclusion that the reluctance of banks to borrow is weakening and needs reinforcement from discount rate adjustment to put back in play a better degree of restraint on credit expansion. The discount rate was pinned down at the existing 1¾ per cent level by agreement with the Treasury when the bond market was unpegged in March, 1951. Since then the general structure of money rates has moved upwards and away to the extent of ⅛ per cent or more. The agreement with the Treasury to keep the 1¾ per cent rate expired at the end of 1951 and an unpegging of the discount rate would be a natural sequence if it is to be restored as a flexible instrument of credit policy. Immobilized at a level that invites abuse of the discount privilege, it can stand as a threat to economic stability.

Foundations of Money Value

The value of the dollar has many underpinnings, not least of which are the production power of the nation, the energies of the people, and the respect of people for the soundness of the financial policies pursued by government. Although the shrinkage in the dollar has given the citizen reasonable ground for doubt, by and large he has displayed an abiding faith in the integrity of government financial policy. To protect his money he has accepted tax burdens beyond any his forefathers were ever asked to bear. He has continued to buy Savings bonds and responded to moderate increases in interest rates to fortify his savings. He has bought life insurance and sought pension benefits, all of which are based on the presupposition that the dollar will be good money.

What is needed is a reinforcement of faith. The means are at hand to do it.

Budget and Tax Outlook

Barring the question of war or peace, probably the Number One question raised by the election in the minds of the American people is, what is the new Administration going to do about government spending and taxes?

In his campaign for the Presidency, General Eisenhower adopted as a central part of his program the promise, if elected, to cut government spending drastically, and so pave the way for relief from the present heavy burden of taxes. This promise was pin-pointed by Senator Taft, following the Taft-Eisenhower meeting in New York on September 12, as follows:

> General Eisenhower emphatically agrees with me in the proposal to reduce drastically over-all expenses. Our goal is about 70 billion dollars in the fiscal year 1954, and 60 billion dollars in the fiscal year 1955. That would make possible a reduction in taxes to the 60 billion level for the year 1955. Of course I hope we may do better than that.

Since the election, Republican leaders have reaffirmed these objectives, and some have envisioned the possibility of making a start on cutting taxes in the next session of Congress.

Present Budget Situation

The magnitude of the task of budget cutting and tax relief which the new Administration has

marked out is indicated by the following table giving latest official budget totals:

U. S. BUDGET TOTALS
(Fiscal years. In billions)

	1951 Actual	1952 Actual	1953 Estimated Jan.	1953 Estimated Aug.
Receipts	$48.1	$62.1	$71.0	$68.7
Expenditures	44.6	66.1	85.4	79.0
Surplus (+) or Deficit (—)	+3.5	—4.0	—14.4	—10.3

It will be seen that, according to the August budget revision, expenditures this fiscal year are expected to total $79 billion, against receipts of $68.7 billion, leaving a deficit of $10.3 billion. Rumors as the size of the budget for fiscal 1954 to be presented by President Truman early in January range from $80 to $85 billion. Thus, if this should be true, attainment of the Republican goal of a $70 billion ceiling on expenditures for fiscal '54 would call for a saving of $10 to $15 billion, depending on the amount of the Truman budget to be revealed after the first of the year.

Still this is not enough. For, as the table shows, cutting the budget to $70 billion will serve only to eliminate the deficit, assuming maintenance of present revenues. It leaves no room for tax reductions. The fact is that the Treasury over the next eighteen months faces, under existing legislation, expiring dates of certain tax increases voted last year which are estimated to be yielding at the rate of $8½ billion annually. Dates and amounts of such tax reductions, as estimated by the staff of the Joint Congressional Committee on the Economic Report and the only official figures so far available, are as follows:

June 30, 1953—Corporate excess profits tax to expire. Annual revenue loss $2.5 billion.

December 31, 1953—Individual income levies to decrease an average of 11 per cent. Annual revenue loss $3 billion.

April 1, 1954—Corporation income levies to decrease 5 percentage points. Annual revenue loss $2 billion. Also, certain excise levies, including principally those on automobiles and trucks, cigarettes, gasoline, alcoholic beverages, and sporting goods, to return to lower rates prevailing before the 1951 tax bill. Annual revenue loss $1 billion.

Inasmuch as these estimated revenue losses are at annual rates, they would be only partly reflected in fiscal '54 receipts.

Alternatives Facing the New Administration

Here, then, are the alternatives facing the new Administration and Congress. Unless, both, acting together, address themselves with real vigor and determination to the task of reducing expenditures, they have only the alternatives of (1) accepting an unbalanced budget and deficit financing, or (2) foregoing tax relief, including those reductions scheduled to occur automatically under provisions of existing law.

Neither of these alternatives can be considered admissible. Not only would either be in violation of campaign pledges but it would be bad medicine for the country. Under present conditions of business boom and full employment there is no excuse, in the absence of all-out war, for running a Treasury deficit. By every theory of government finance, this is a period for insisting upon a balanced budget as a minimum objective of fiscal policy.

At the same time we ought to be moving as rapidly as possible towards cutting back the present excessive tax load, with its adverse long-term effects upon the economy. It would be of great value to the growth of enterprise if the recent tax increases should be allowed to run out in accordance with the schedule already set up by Congress.

The latter statement applies most immediately to the corporate excess profits tax, due to expire June 30 next. The evils of this tax are now recognized almost universally. As regards the Treasury attitude, Secretary Snyder has indicated that he is not "enthusiastic" about continuing E.P.T. Speaking at a press conference last September, the Secretary referred to this tax as "the most difficult tax to administer that has ever been conceived," and added:

> It is almost impossible to make it equitable — to find a proper base period for all types of business. I don't see how you can tax efficiency, ingenuity and good management . . . I personally believe Congress will scrutinize that area very carefully before they extend it—if they do.

Were this tax, with its innumerable problems, to be extended, some effort would have to be made to rectify its deficiencies. Any such attempt would be sure to invite a veritable Pandora's box of proposals for ameliorating hardships and taking care of special cases, probably ending up by making the tax more complicated than ever.

Thus, in the end, we come back to the position taken at the outset — namely, that government costs must be reduced.

Where's the Money Coming From?

How are these vast savings to be accomplished?

In the first place, the problem, staggering though it be, is actually somewhat less formidable than it appears on the surface. This is because of the constant tendency in recent budgets to over-estimate expenditures. Thus, as the budget table above shows, President Truman's original estimate of $85.4 billion expenditures for the current fiscal year 1953 was reduced in the Au-

gust revision to $79 billion — a decrease of nearly $6½ billion, attributable partly to Congressional action in paring appropriations and partly to lag in spending. While the revenue estimate also declined, the indicated deficit dropped from $14.4 billion in January to $10.3 billion in August. Now it appears that even these figures may prove too high, and that actual expenditures this year may run substantially below the $79 billion forecast in August, thereby narrowing correspondingly the cuts necessary to achieve the goal of a $70 billion top on expenditures for fiscal '54.

Secondly, it may be repeated that, so far as fiscal '54 is concerned, the scheduled tax cuts will become only partly effective, thus easing the transition to a lower budget basis in that year. Only in succeeding years will the tax cuts be fully felt, when there will be more time to make necessary economies.

Thirdly, no one knows precisely what the loss in revenues resulting from lower tax rates would be. In the case of the excess profits tax, particularly, it is widely recognized that removal of this tax would strengthen the incentive for more careful control of corporate expenditures, which should result in an increase in profits subject to regular income tax.

Finally, it must be recognized that the fiscal problems on expenditures go beyond the new budget which will be presented to Congress by the outgoing Administration in January. Of the expenditures presently authorized, it is estimated that at the end of June 1953 some $70 billion will remain unspent but committed for in various degrees. This backlog — nearly equal to annual expenditures — which under present practice is spendable on old business, is itself a major problem in controlling the budget. One of the first tasks of the new Administration and of the new Congress must be to dig into this backlog of "unfinished business" and see where recisions can be made. Experience indicates that such opportunities can be found.

Also, there are all the various programs of guarantees and subsidies which have been built into the laws over these many years. Some of these will undoubtedly be continued, but some appear ripe for sharp reductions or elimination. In due course these will have to be reviewed, sorted out, and as many as possible brought under some annual control if we are to regain fiscal control of annual outlays.

More Defense for Fewer Dollars

The great question, of course, that everyone asks about the budget is, how much can we cut without endangering our national defense? This is, indeed, the core of the problem, for with national security expenditures accounting for some three-quarters of the total budget it will be impossible to make adequate overall savings if military items are to be regarded as untouchable. At the same time no true American wants to gamble on accepting a real defensive strength below our needs.

Thus what the question comes down to is, are we spending our money as wisely and effectively as possible? In short, are we getting the most for our defense dollars?

Testimony from innumerable sources, including business men having contacts with the government departments, well-informed members of Congress, reports of Congressional committees, and studies by competent private groups, indicate that we are not, and that a great deal could be accomplished by a tightening up of policies and procedures. In general, the evidence available points to need for reforms along the following main lines: (1) elimination of waste and extravagance, (2) adoption of sound procurement methods, (3) improvement in character and timing of the weapons program, (4) accomplishment of real armed services unification with an overall strategic plan.

Views of General Eisenhower

This is also the view expressed by General Eisenhower during the campaign. Again and again he has insisted that "we can have more defense for less money." Thus, in a major address on national defense in Baltimore September 25, he declared (referring to the "$60 billion we pay for national security"):

> Here is where the largest savings can be made. And these savings must be made without reduction of defensive power. That is exactly what I am now proposing. To accomplish this will require the help of civilian leaders — business, labor and professional — who really know their jobs. Their wisdom and experience must be combined with the wisdom and experience of military men from the three Services to get satisfactory results. They must have the full support of the President and enjoy the confidence of Congress.

He said in the same address: "Here are three personal convictions which I hold to be true: First, our defense program has suffered from lack of far-sighted direction. Second, real unification of our armed services is yet to be achieved. Third, our defense program need not and must not push us steadily toward economic collapse."

To meet the challenge of fast moving events we must, he said, have a new approach. We quote:

First: We must press for a weapons program that is realistic. We cannot pretend to do everything in every field all of the time. Any attempt to do so would waste as much skill as money. For this reason, our judgment in weapon development must be sure and sound and related to tactical needs. To do this the professional fighting man requires the advice and knowledge of both industry and labor . . .

Second: To save money and increase efficiency we must emphasize simplicity in design . . .

Third: More civilian personnel and direction must be called into the weapons program. . . . All that I have said about how to save money and avoid waste in the weapons program applies with equal force to other parts of the defense program.

Coming to what he described as the "supremely important matter of unification of the armed forces," the General minced no words in revealing how progress has lagged:

It was the hope and expectation of all of us who worked to achieve the passage of the National Defense Act of 1947, that this kind of unity was in the making.

This has not proved to be the case. Such unity as we have achieved is too much form and too little substance. We have continued with a loose way of operating that wastes time, money and talent with equal generosity. With three services, in place of the former two, still going their separate ways and with an over-all defense staff frequently unable to enforce corrective action, the end result has been not to remove duplication, but to replace it with triplication.

All this must be brought to as swift an end as possible.

He then proceeded to outline two major proposals:

First, a real top grade restudy of the operations of the Defense Department by a commission of "the most capable civilians in our land," to be appointed at the earliest possible date next year. Members of the commission should be men and women specifically qualified for their tasks and drawn from both parties to exclude politics. They should be assisted by the ablest officers available from all services — Air Force, Army, Navy, and Marine Corps — but be free of domination by those services themselves.

Second, a revamping of the National Security Council, now charged with high level planning for national security. Declaring that that planning "has failed time and again these last years," he criticized the present set-up limiting membership to cabinet officers and heads of administrative agencies, "already burdened by the duties of their offices." To correct this situation, which as he put it had made the Council "more a shadow agency than a really effective policy maker," he proposed appointing "civilians of highest capacity, integrity and dedication to public service."

Of course, success in carrying out these programs is not easily attained. The present Secretary of Defense, Mr. Robert A. Lovett, as well as former Secretaries, has been conscious of major shortcomings in the defense organization and and has labored hard to correct them. Already progress has been made with respect to manpower, procurement, research, and other phases of defense. The problem, however, is so huge and so complicated that thus far only a dent, comparatively, has been made in it. A great difficulty has been the lack of a broad-based program such as outlined by General Eisenhower.

The evident grasp of the problems displayed by the President-elect, his long military service, and the nature of his proposals for reforms in operating methods and high level policy-making afford grounds for expecting a real breaking of the log-jam. Already he has moved to implement his pledge to seek out the best possible business talent to head up the Defense Department. His appointment of Mr. Charles E. Wilson, President of the General Motors Corporation, to that post is in line with his statement early in the campaign:

Until we get business brains in a $60,000,000,000 business — and I mean business brains that Congress will respect — we are not going to save the money that we can without losing one tank, one plane, one ship, one anything just because of that.

The Wilson appointment is a heartening step towards combining security with economy, and a hopeful augury of other steps to come.

The Battle on Other Fronts

Foreign aid is tied into military spending, and here too there is need for reappraisal of the whole picture, both from the standpoint of eliminating extravagances which are not helping but hurting us abroad, and of measuring progress against objectives and weighing possible new approaches.

Though the defense portion of the budget bulks so large, making it the chief item for attention, it is not the whole budget; and it is just as essential that the country is not burdened with unnecessary non-military costs when the demands for military outlays are so great.

It would be possible, were space available, to go on and give case after case of non-military spending where reductions can and should be made. Both Congress and the Administration will be expected to subject these and other non-military items to the same searching scrutiny accorded the military budget. As in the latter case, results are not likely to come easily. There will be resistance throughout the countless offices and bureaus, built up over long years of big

spending philosophy and tolerance of waste and extravagance, to efforts to trim the scope of their operations and prerogatives. There will be outcries from public pressure groups, long accustomed to handouts from the Treasury.

To do the job will call for a tougher attitude by the Bureau of the Budget and by the appropriations committees of Congress. The latter will need adequate and competent staffs for thorough sifting of departmental requests so that decisions can be made with full knowledge of the facts. With the chairmanships of these committees in the new Congress held by men experienced in problems of the budget and genuinely concerned with saving the taxpayer's dollars, with many other doughty champions of economy in both Houses ready to lend their aid, and with leadership and sympathy in the White House for what they are trying to do, we should be able, at long last, really to get somewhere in reducing the cost of government.

Industrial Expansion and Working Capital

Since the end of 1949 the great expansion of American industry for meeting the country's combined defense and civilian requirements has used for its financing some $36 billion in new capital, net of plant expenditures offset by depreciation charges. Including the preceding wartime and postwar programs of expansion, the total absorption of new funds by the manufacturing industries has aggregated approximately $100 billion. In addition to the heavy capital outlays on plant, there has been a large absorption of new funds in carrying increased inventories and receivables, as well as for the build-up of cash and government security holdings necessary to provide liquidity and carry on the increased business.

Total balance sheet assets have risen from $60 billion at the end of 1940 to $160 billion by the middle of 1952. Advancing costs have caused the expansion as measured in dollars to exceed the actual increase in physical equipment, but the increase in productive capacity has been very substantial in numerous lines.

The varying types of demand for funds during these three periods of expansion since prewar are shown in the accompanying composite balance sheet for all U.S. manufacturing corporations. It shows also the principal sources from which the funds have been obtained. While the major share of the new capital has come from the retained earnings of the corporations themselves, an increasing portion has had to be raised by bank and other borrowing, both current and long-term. This has pulled down the liquidity of industry from the unusually high levels reached after the war. Figures for the years 1940-49 are from the Treasury Department annual Statistics of Income; those for June 1952 are from the joint quarterly study by the Securities & Exchange Commission and the Federal Trade Commission.

All Manufacturing Corporations in the U.S.

(In Billions of Dollars)

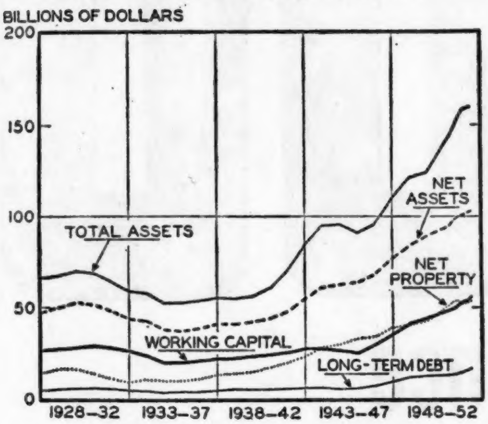
	Dec. 31 1940	Dec. 31 1945	Dec. 31 1949	June 30 1952
Assets				
Cash	$ 5.7	$11.3	$12.6	$15.3
Government securities	1.1	11.0	9.4	11.3
Receivables, net	8.4	13.6	16.1	22.1
Inventories	12.3	17.3	27.8	42.9
Other current assets	*	*	*	2.2
Total current assets	27.6	53.1	65.9	93.7
Plant and equipment	42.7	53.8	79.1	100.4
Less depreciation	19.1	28.7	35.0	44.7
Net property	23.6	25.1	44.1	55.7
Other investments	8.2	10.1	11.3	*
Other assets	1.1	2.7	2.4	10.3
Total assets	60.5	91.0	123.8	159.7
Liabilities and Capital				
Accounts payable	5.3	8.3	10.2	13.7
Notes payable	2.0	2.7	3.1	5.9
Federal income taxes	*	*	*	12.9
Other current liabilities	3.7	9.4	9.3	6.9
Total current liabilities	11.0	20.5	22.6	39.4
Long-term debt	5.4	6.4	12.3	16.8
Capital and retained earnings	44.2	64.2	88.9	103.4
Total liabilities and capital	60.5	91.0	123.8	159.7
Net Working Capital	16.6	32.6	43.3	54.3
Ratios:				
Current assets to current liabilities — %	252	259	291	238
Cash and govt. securities to current liabilities — %	63	109	98	67

* Not compiled separately.

It will be seen that of the expansion in total assets since prewar, aggregating practically $100 billions, the wartime period 1941-45 accounted for approximately $31 billion, the postwar years 1946-49 for $33 billion, and the three following years for $36 billion. The longer-term growth may be seen from the chart covering the 25-year period 1928-52.

Although the vast capital outlays for building enlarged plants have been the most spectacular feature of the years since 1940, the absorption of funds in current assets has actually been larger, accounting for $66 billion or two-thirds of the net dollar total. Increased inventories, reflecting larger stocks as well as higher prices, absorbed $31 billion and increased receivables $14 billion, while holdings of cash and government securities were built up by $10 billion each. Total property account increased by $58 billion, but this was offset by an increase in the reserves for depreciation, depletion, and amortization of $26 billion, so that net property account increased by only $32 billion. The net

use of funds, as measured by the expansion of balance sheet assets, therefore differs from the gross turnover of funds by the substantial reserves which write down, or completely write off, the book valuations of property assets.



All U.S. Manufacturing Corporations

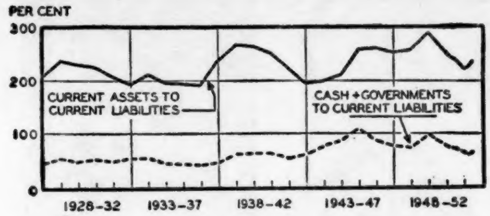
On the other side of the balance sheet, it will be seen that the new funds came to a major extent, nearly 60 per cent, from building up the net assets — principally by the retention of earnings. New stock issues sold to investors provided only 3 per cent of the total funds needed.

Need for Increased Borrowing

Despite the large portion of new funds provided by corporate earnings, a substantial increase in bank and other borrowing has been necessary, particularly since Korea. The manufacturing corporations since prewar have increased their current liabilities, including accounts payable, income tax reserves, and other accruals, by $28 billion, in addition to which their long-term debt has increased by $11 billion.

Working capital — the excess of total current assets over total current liabilities — has continued to build up year after year despite the heavy investment of funds in plant and equipment. As the chart shows, it has kept approximately equal to the net property account. Liquidity, however, has been pulled down sharply from the peaks of the postwar period, although it is still above the levels prevailing generally before the war. In the first half of 1952, the S.E.C.-F.T.C. quarterly study indicates a reversal of the downtrend with a slight upturn, as may be seen from the chart showing the working capital ratios.

For example, the ratio of total current assets to total current liabilities, which at the end of 1945 stood at 259 per cent and by the end of



Working Capital Ratios of All U.S. Manufacturing Corporations

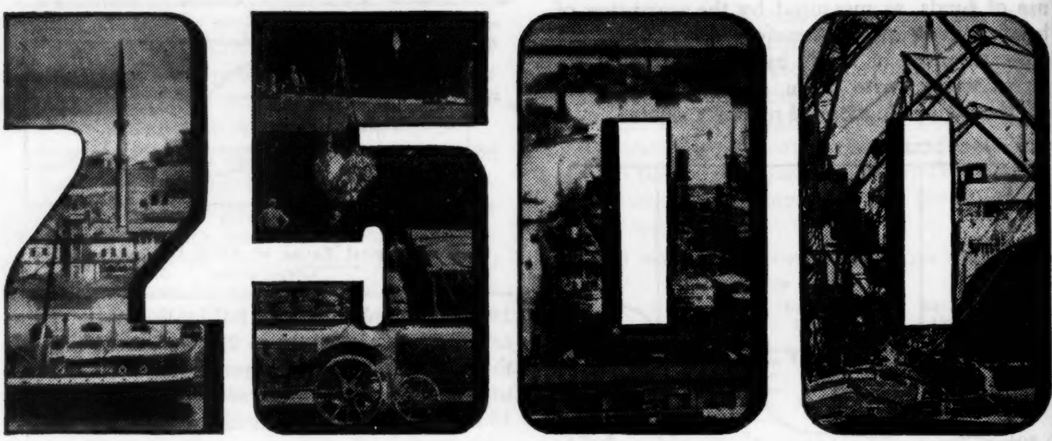
1949 had climbed to 291, fell by the end of 1951 to 223, then moved up to 238 by June 1952. In the fifteen prewar years from 1926, when Treasury statistics first became available, through 1940, this ratio averaged 221 per cent.

Excluding the large portion of current assets absorbed in inventories, which involve risks of both price and liquidity, as well as the funds tied up in receivables, the ratio of cash plus government securities alone to total current liabilities declined from 98 per cent at the end of 1949 to a postwar low of 63 in March 1952. In the June quarter it improved slightly, to 67 per cent, reflecting not only the payment of federal income taxes but also some liquidation of inventories. This ratio during the years 1926-40 averaged 50 per cent.

The fact that working capital and liquidity have been relatively well maintained for American industry as a whole does not, of course, mean that all individual companies have been able to keep in comfortable position. Not only has borrowing been substantial, as the composite balance sheet shows, but it has been concentrated since Korea in a relatively few branches. Out of twenty-one major industry classifications, the sharpest debt increases have taken place in seven: lumber and wood products, primary nonferrous metals, fabricated metal products, industrial machinery, electrical machinery, transportation equipment except motor vehicles (i. e., aircraft and railway equipment), and miscellaneous manufacturing including ordnance.

Economic progress based on continual expansion and modernization of plants requires, of course, a huge supply of new capital. In the future an increasing amount of such money will become available through the charges for depreciation and depletion — expense items involving no cash outlay which more and more will come to reflect the rise in plant and equipment costs on which they are based. For all U.S. manufacturing corporations such charges in the first half year 1952 reached an annual rate of $5 billions — three times that of 1940.

more than



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